

**Before the
FEDERAL COMMUNICATIONS COMMISSION**

)	
)	
In the Matter of)	
)	
Skype Communications S.A.R.L.)	RM-11361
)	
Petition to Confirm a Consumer's Right)	
to Use Internet Communications Software)	
and Attach Devices To Wireless Networks)	
)	
)	

REPLY COMMENTS OF VIRGIN MOBILE USA, LLC

Antoinette C. Bush
John M. Beahn
Skadden, Arps, Slate, Meagher
& Flom LLP
1440 New York Avenue
Washington D.C. 20015

Peter Lurie
General Counsel
Virgin Mobile USA, LLC
10 Independence Blvd
Warren, NJ 07059

SUMMARY

Skype's request for extension of the *Carterfone* principle to the wireless industry is based upon a fundamental misreading of the rationale underlying the *Carterfone* decision. *Carterfone* was decided in a vertically integrated, monopoly era to remediate the effects of AT&T's dominant position in the marketplace. In stark contrast to the monopolistic and stagnant market landscape of the *Carterfone* era, today's wireless market is characterized by robust and increasing competition. Unlike the market at the time of the *Carterfone* decision, moreover, today's wireless industry is not vertically integrated. Neither the wireless services sector nor the handset equipment market resembles, in any way, the market examined by the Federal Communications Commission ("FCC" or "Commission") at the time of the *Carterfone* decision. Competition among wireless service providers has stimulated an increasingly competitive handset equipment market in which innovation is flourishing. Recognizing that this competitive and innovative market protects consumers from the type of harm addressed in the *Carterfone* decision, the Commission should deny Skype's Petition.

Skype's focus on the handset practices of wireless carriers is similarly misguided. Contrary to its contention, these practices respond to wireless consumers' demands for inexpensive and reliable handsets. The availability of low-priced and reliable handsets that complement its unique service offerings has been one of the keys to Virgin Mobile's success in attracting customers, especially lower-income and younger customers. In additions, Skype's solutions to the invented problem of wireless handset practices could unwind much of the competitive success achieved in the wireless market during the past twenty years. Wireless customers in general, and Virgin Mobile's customers in

particular, would be ill-served if the Commission were to adopt Skype's proposals since they would inevitably lead to more expensive handsets and less choice for consumers.

**Before the
FEDERAL COMMUNICATIONS COMMISSION**

)	
)	
In the Matter of)	
)	
Skype Communications S.A.R.L.)	RM-11361
)	
Petition to Confirm a Consumer's Right)	
to Use Internet Communications Software)	
and Attach Devices To Wireless Networks)	
)	
)	

REPLY COMMENTS OF VIRGIN MOBILE USA, LLC

Virgin Mobile USA, LLC ("Virgin Mobile"), by undersigned counsel hereby opposes the Petition for Rulemaking filed by Skype Communications seeking extension of the *Carterfone* principle to the wireless industry.¹

I. BACKGROUND

A. Virgin Mobile is an Innovative Wireless Carrier Successfully Competing in the U.S. Market

Virgin Mobile is an innovative wireless carrier that provides its customers with fun, lifestyle voice and data features and unique, prepaid service plans. Virgin Mobile's simple and straightforward pay-as-you-go, or prepaid, pricing, along with its differentiated service offerings and high-quality customer service, have helped to

¹ See *Petition to Confirm a Consumer's Right to Use Internet Communications Software and Attach Devices to Wireless Networks*, Skype Communications S.A.R.L., RM-11361 (filed Feb. 20, 2007)(hereinafter, "Skype Petition").

redefine the prepaid wireless marketplace and brought significant competition to the overall wireless market. As a result of its appealing service offerings, Virgin Mobile has become one of the ten largest wireless carriers in the country, acquiring nearly five million customers since its launch in July 2002.

Virgin Mobile targets its service to a broad range of customers, including customers that have previously been unable to afford or access wireless service, especially the lower-income and youth customer segments. Indeed, more than 50 percent of its customers were new to wireless service prior to receiving service from Virgin Mobile. Many of these consumers did not previously enjoy access to an attractive wireless service because of financial constraints, poor credit history, or excessive handset prices. By marketing and expanding the availability of wireless services to those otherwise unable to afford service or those previously ignored by traditional carriers, Virgin Mobile has effectively expanded access to wireless services.

To attract its customers, Virgin Mobile does not impose credit checks, long-term service contracts, or early termination penalties as a prerequisite to service. Virgin Mobile also offers a variety of pricing plans that appeal to customers, including both flat-rate pricing and monthly hybrid plans in which customers can buy buckets of minutes without long-term contracts. Under each of these plans, customers know exactly how much they are going to pay on a per-minute basis, pay in advance, and have the ability to add minutes of use on their handset, online, or by phone, using a top-up card or credit card, whenever they want. As important, Virgin Mobile offers a wide variety of low-priced handsets, which appeal to its customers. Virgin Mobile currently works with three manufacturers to offer a total of ten handsets; all of which retail for below \$100 and six

of which retail for below \$50. These handsets all include features and applications that appeal to its customer segments.

Like most carriers, Virgin Mobile subsidizes the costs of its handsets and retails them at prices significantly below Virgin Mobile's per-unit wholesale cost (as well as the market value of the handset). Subsidizing handsets has enabled millions of Virgin Mobile customers to purchase handsets and obtain Virgin Mobile's wireless service without significant capital outlay. Since Virgin Mobile sells its handsets to consumers at greatly subsidized prices, it is especially important that the customer use that handset on the Virgin Mobile network. As noted above, Virgin Mobile does not impose long-term service contracts or substantial early termination penalties. It, therefore, must earn back the subsidy through revenue obtained from the provision of voice, data, and entertainment applications to customers. To ensure that it can recover the handset subsidy from customers through service revenues, Virgin Mobile incorporates proprietary software into its handsets that ensures use of the handset on the Virgin Mobile network. Without the assurance that its mobile phones would be used on its network, Virgin Mobile would be unable to subsidize the retail prices of its handsets and prices would rise by several orders of magnitude, greatly limiting access to prepaid services.

II. SKYPE'S REQUEST FOR AN EXTENSION OF THE *CARTERPHONE* PRINCIPLE TO THE WIRELESS MARKET IS LEGALLY MISGUIDED AND FACTUALLY UNSOUND

A. Skype's Request for Commission Intervention is Inconsistent with the Commission's Legal Reasoning in the *Carterfone* Decision

Skype's Petition is based upon a fundamental misreading of the *Carterfone* decision.² While Skype's request regarding the right to attach any device to a wireless network should be rejected for the reasons detailed in Section III below, its request with respect to the right to run applications of a customer's choosing goes well beyond the holding in *Carterfone* and cannot be supported by this precedent. Skype constantly blurs the distinction between the *Carterfone* principle of allowing customers to attach devices of their choosing to the wireline network with the concept of granting customers the unlimited ability to use the underlying network for any purpose. In its Petition, Skype notes that extension of the *Carterfone* principle to the wireless market would "stand as an explicit endorsement that consumers have an unfettered right to run applications of their choosing."³ To be clear, Skype is not only requesting that the Commission grant the right to connect *equipment* of a customer's choosing to the network. Instead, Skype has requested that the Commission rule that end users have "rights to run the Internet *applications* of their choosing" on any wireless network.⁴ To spur development of a competitive market for end user equipment, *Carterfone* confirmed only the ability of customers to connect hardware of their choosing to the wireline network.⁵ It did not provide customers, and does not today, with the right to use the underlying network for any purpose of their choosing.

B. *Carterfone* Was Decided in a Vertically Integrated, Monopoly Era to
Remediate the Effects of AT&T's Dominant Position in the Marketplace

² See *In the Matter of Use of the Carterfone Device in Message Toll Telephone Service*, 13 F.C.C.2d 420 (1968)(hereinafter "*Carterfone*").

³ *Skype Petition* at p.6.

⁴ *Id.* at p.6.

⁵ See *Carterfone* at p.423 (holding that the AT&T tariff at issue in the proceeding "is unreasonable in that it prohibits the use of interconnecting *devices* which do not adversely affect the telephone system.")(emphasis added).

Skype analogizes its request for regulatory intervention to prior Commission proceedings which, according to Skype, "limit[ed] the ability of network operators to leverage their control over the transmission network into the adjacent market for equipment and the software that runs on that equipment."⁶ What Skype fails to mention, however, is that each of these prior Commission proceedings, including *Carterfone*, sought to stimulate competition in an otherwise non-competitive market. As other carriers have noted, *Carterfone* was decided in an era in which AT&T, a vertically integrated, government-sanctioned service monopoly, dominated the United States telecommunications market.⁷ AT&T's position as the dominant provider of telecommunications services enabled it to leverage its monopoly control of the underlying telecommunications facilities and networks into the manufacturing sector to inhibit the deployment of third-party end user equipment. This behavior led to high prices, reduced supply, and limited innovation in the telecommunications end user equipment market. Faced with this reality, the Commission rightly sought to introduce competition into the end user equipment market by requiring AT&T to permit the attachment of any end user equipment to the network so long as that equipment posed no threat to the underlying network. In its decision, the Commission reasoned that "[n]o one entity need provide all interconnection equipment for our telephone system...."⁸

As other participants in this proceeding have observed, the *Carterfone* decision, as well as the Commission's subsequent proceedings examining the bundling of consumer premises equipment, have bred an extremely vibrant market for end user

⁶ Skype Petition at p.8.

⁷ See MetroPCS Comments at p.4.

⁸ *Carterfone* at p.427.

telecommunications equipment.⁹ Telephones, fax machines, digital subscriber line modems, and a broad array of other end user equipment that connect to the wireline network today are provided by a host of third-party manufacturers non-existent forty years ago. The innovative products manufactured by these providers has produced a host of services and capabilities unimaginable to consumers in the *Carterfone* era.

III. THE WIRELESS SERVICES AND HANDSET EQUIPMENT MARKETS ARE BOTH COMPETITIVE UNLIKE THE *CARTERFONE* ERA

A. The Wireless Services Market is Intensely Competitive

In stark contrast to the monopolistic and stagnant market landscape of the *Carterfone* era, today's wireless market is characterized by robust and increasing competition. Neither the wireless services sector nor the handset equipment market resembles, in any way, the markets examined by the Commission at the time of the *Carterfone* decision. Competition in today's marketplace has resulted in substantial innovation not only in wireless voice and data services, but also in handsets and end user equipment. Customers today have a myriad of choices for service providers, pricing options, service plans, handsets, and other equipment. In today's market, service providers have the choice to work with dozens of handset manufacturers. This competition results from wise regulatory policies that the Commission implemented over twenty years ago for the licensing and operation of wireless services and the light regulatory touch that the Commission has applied in recent years. The Commission's regulation of wireless services has facilitated development of the most competitive business in the U.S. communications sector. Without question, the Commission has done its job; it need not do more.

⁹ See *Comments of T-Mobile USA, Inc.* at pp.4-5.

B. Because the Wireless Industry is Not Vertically Integrated, the Carterfone Principle is Unnecessary

Unlike the market at the time of the *Carterfone* decision, today's wireless industry is not vertically integrated. Wireless carriers seldom manufacture the equipment or handsets used on their networks. Instead, carriers work in conjunction with dozens of equipment manufacturers to create handsets that appeal to various consumer tastes and needs. Of particular importance is that this vibrant market for wireless equipment developed in the absence of government mandates or intrusive regulation. The clear impetus behind this competitive market has been the competition among wireless providers and continued innovation in service offerings and wireless features.

Competition among wireless service providers has stimulated a robust and competitive handset equipment market. In contrast to the equipment marketplace of the *Carterfone* era, competition among differentiated service providers has driven rapid expansion and innovation in the handset market. There are dozens of manufacturers that currently sell handsets into the U.S. market. Virgin Mobile, itself, sources handsets from three vendors and offers over ten handsets to its customers. Most important for the Commission's analysis is that handset manufacturers are independent of the wireless service providers; a clear distinction from the era in which the *Carterfone* restrictions were imposed.

C. Alternative Carriers, Innovative Business Plans and Emerging Technologies are Flourishing Because of the Competitive Marketplace

Many other participants in this proceeding have attested to the vibrant competition that currently exists in today's wireless market, and Virgin Mobile will not

swell the Commission's docket with additional statistics to support this undeniable reality.¹⁰ Contrary to Skype's contention that the wireless market has matured and needs regulating, the numerous submissions in this proceeding confirm that competition in the wireless market is widespread and increasing.¹¹ Virgin Mobile's rapid success in acquiring customers previously lacking wireless service proves that competition for "new" customers does exist. Virgin Mobile's success as a resale carrier, coupled with the subsequent entry of additional Mobile Virtual Network Operators ("MVNOs"), provides further evidence that innovative business plans and differentiated service offerings can succeed in today's market.¹²

Virgin Mobile's market success over the last five years also refutes Skype's argument that no "maverick" has emerged in the U.S. market to challenge the status quo. Virgin Mobile's prepaid, pay-as-you-go service plans and its focus on a previously unserved customer segment confirms that new business models can emerge and challenge pre-existing business notions. Prepaid carriers and service plans are an undoubted source of increasing competition in the wireless market.¹³ Many analysts have determined that the future growth in the wireless market will come largely from prepaid service offerings.¹⁴

¹⁰ See *Comments of AT&T Inc.* at pp. 5-11; *T-Mobile Comments* at pp. 9-18.

¹¹ See e.g., *Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, Eleventh Report, FCC 06-142 (rel. Sept 26, 2006)(hereinafter "*Eleventh Annual Report*").

¹² See *Eleventh Annual Report* at para. 28 (noting that "resale competition has been growing....").

¹³ See *Eleventh Annual Report* at para. 94 (noting the "significant rise in the percentage of wireless users who subscribe to prepaid plans....").

¹⁴ The Yankee Group has called the prepaid wireless sector the fastest growing segment of the wireless industry and estimated that approximately 40 percent of all new wireless accounts will be prepaid accounts by the year 2009.

Competition in the data and entertainment applications market also is increasing. Upstart carriers, such as Virgin Mobile, have led the deployment of these services, successfully differentiating their service offerings from those of other carriers. Virgin Mobile, itself, has been at the forefront in offering the interactive wireless non-voice features and services that customers demand today. Competition from emerging carriers in these non-voice features undercuts Skype's contention that regulatory intervention is necessary to ensure that consumers have access to new service features, capabilities, and technologies.

D. When Measured Against this Competitive Backdrop, Skype's Petition Should be Rejected

Stripped of its false assumptions regarding wireless competition, Skype's Petition collapses under the weight of its misguided logic. Today's competitive market protects consumers from the type of harm that the Commission sought to address in the *Carterfone* decision. Contrary to Skype's perception, moreover, wireless carriers do not have significant bargaining power over equipment manufacturers. The competition among carriers for handsets containing next-generation features and capabilities prevents anticompetitive coordination between carriers and manufacturers. In this regard, Skype has requested that the Commission fix a problem that does not exist.

Skype's Petition simply seeks a regulatory crutch to provide it with a mandatory right to use the spectrum and networks of other carriers. Virgin Mobile did not seek such assistance when it launched service over five years ago. Instead, Virgin Mobile negotiated and contracted for the right to access the Sprint Nextel network and invested the capital necessary to build an innovative business. Virgin Mobile's success in

servicing its customers proves that the wireless market currently provides opportunities for new competitors to provide wireless voice and data services. Indeed, there are innumerable new service providers entering the U.S. market at this time.

IV. CONSUMERS ARE THE BENEFICIARIES OF COMPETITION AND SKYPE'S PETITION WILL INCREASE CONSUMER COSTS AND LIMIT CHOICE

A. Skype Mistakenly Identifies Consumer-Preferred and Beneficial Practices as "Market Distortions"

To support its request for extension of the *Carterfone* principle to the wireless market, Skype highlights what it views as "distortions" in the wireless market.¹⁵ As noted below, Skype improperly claims that these distortions cause consumer harm both at the handset and applications layers. According to Skype, consumer harm at the handset layer results from carrier disabling of handset features and "locking" handsets to a particular network, while harm at the applications layer involves carrier terms of service limitations (e.g., bandwidth restrictions) and a lack of open development standards for wireless operating systems.¹⁶

Skype's complaints regarding the negative effect that carrier "locking" practices have on consumers is misguided. Virgin Mobile subsidizes its handsets as an efficient promotional technique to acquire customers. As described above, many of Virgin Mobile's lower-income customers would be unable to afford wireless services if not for these handset subsidies. To recoup these subsidies through revenue from voice and data services, Virgin Mobile requires that its handsets be used only on its network. If Virgin Mobile were unable to require use of its handsets on its network to recoup its upfront investment, it would greatly reduce subsidies for all of its handsets, increasing retail

¹⁵ Skype Petition at p.9.

¹⁶ See *id.* at pp. 8-11

prices dramatically. Such a result would greatly harm lower-income customers who have come to rely on Virgin Mobile's inexpensive handsets as a viable alternative to the more expensive handsets offered by other carriers.

Skype's focus on carrier disabling of handset features is similarly unwarranted. What Skype fails to recognize is that each feature and capability included in a handset increases its cost. The availability of low-priced handsets that complement its unique service offerings has been one of the keys to Virgin Mobile's success in attracting customers. Were Virgin Mobile to incorporate every available feature and capability offered by handset manufacturers into its handsets, the resulting handsets would be too expensive for its customers. To remain competitive, Virgin Mobile must incorporate features and capabilities that increase the utility and appeal of its handsets, but that do not raise the cost of handsets to an unmarketable price.

Finally, contrary to Skype's assertions of anticompetitive discrimination, terms of service and usage limitations remain a vital component of network management for wireless carriers. As many other participants to this proceeding have noted, carriers must adopt such policies to account for the shared nature of wireless spectrum.¹⁷ Improved connection and call reliability for all users depend on the availability of sufficient spectrum at any given time. Absent these policies, a small percentage of customers could consume an inordinate amount of spectrum through use of bandwidth inefficient applications, adversely affecting the wireless experience of all users.

¹⁷ See *AT&T Comments* at pp. 52-55.

V. EXTENSION OF *CARTERPHONE* TO THE WIRELESS MARKET WOULD IMPEDE INNOVATION AND INHIBIT COMPLIANCE WITH VARIOUS GOVERNMENT MANDATES

A. Handset Innovation and Call Quality Would Suffer

Skype's solution of extending the *Carterfone* principle to the invented problem of wireless handset practices could unwind much of the competitive success achieved in the wireless market during the past twenty years. While Skype claims that standardization of wireless software and processes would promote competition, it fails to recognize that such a result would greatly slow the handset development process, undermining the significant innovation currently taking place among wireless carriers and handset manufacturers. Contrary to Skype's claim, moreover, close cooperation between wireless carriers and handset manufacturers has produced immeasurable consumer benefits. For instance, carriers have been able to significantly improve call and signal quality over the past fifteen years by developing and deploying spectrally efficient handsets.

B. Wireless Carriers Would be Unable to Support Various Government-Mandates

Carriers have worked closely with handset manufacturers to ensure that handsets deployed on their networks meet various governmental regulatory obligations, including enhanced 911, Communications Assistance for Law Enforcement Act, and hearing-aid compatibility requirements. Extension of the *Carterfone* principle to wireless networks would seriously impact carriers' ability to ensure that handsets deployed on their networks comply with these important policy objectives. Without the contractual ability to require manufacturers to include certain capabilities, wireless carriers would be powerless to ensure compliance with these requirements.

VI. CONCLUSION

For all of the above-mentioned reasons, Virgin Mobile urges the Commission to reject Skype's request for extension of monopoly era regulations to today's increasingly competitive wireless industry.

Respectfully submitted,

VIRGIN MOBILE USA, LLC

By: /s/
Antoinette C. Bush
John M. Beahn
Skadden, Arps, Slate, Meagher & Flom LLP
1440 New York Avenue
Washington D.C. 20005
Tel: (202) 371-7392

Counsel to Virgin Mobile USA, LLC

Peter Lurie
Virgin Mobile USA, LLC
10 Independence Blvd
Warren, NJ 07059
Tel: (908) 607-4017

Dated: May 15 2007